Consolidated Financial Statements as of December 31, 2002

(In thousands of U.S. dollars)

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders of Elbit Systems Ltd.

We have audited the accompanying consolidated balance sheets of Elbit Systems Ltd. (the "Company") and its subsidiaries as of December 31, 2002, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Elbit Systems Ltd. as of December 31, 2001 and for the years ended December, 2001 and 2000 were audited by other auditors who have ceased operations as a foreign associated firm of the Securities and Exchange Commission Practice Section of the American Institute of Certified Public Accountants and whose report dated March 24, 2002, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2002, and the consolidated results of their operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No, 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002.

Luboshitz Kasierer
An affiliate member of Ernst & Young International

Haifa, Israel,
March 10, 2003

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of Elbit Systems Ltd.

We have audited the accompanying consolidated balance sheets of Elbit Systems Ltd. and its subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Elbit Systems Ltd. and its subsidiaries as of December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

Luboshitz Kasierer
Arthur Andersen

Haifa, Israel,
March 24, 2002

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars)

	Note	December 31 2002	2001
CURRENT ASSETS			
Cash and cash equivalents		$76,280	$40,583
Short-term bank deposits		1,650	1,446
Trade receivables, net	(3A)	227,724	241,827
Other receivables and prepaid expenses	(4)	34,376	36,209
Inventories, net of advances	(5)	222,844	185,090
Total current assets		**562,874**	**505,155**
INVESTMENTS AND LONG-TERM RECEIVABLES			
Investments in affiliated companies and partnerships	(6A)	21,947	19,583
Investments in other companies	(6B)	11,104	11,909
Long-term receivables	(3B)	20,859	64,804
Long-term deposits and loans	(7)	3,686	3,433
Severance pay fund		6,641	6,528
		64,237	**106,257**
PROPERTY, PLANT AND EQUIPMENT NET	(8)	**202,961**	**184,722**
OTHER ASSETS, NET	(9)		
Goodwill and assembled work-force, net		32,541	31,946
Know-how and other intangible assets, net		73,228	73,337
		105,769	**105,283**
		$935,841	**$ 901,417**

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED BALANCE SHEETS (cont.)

(In thousands of U.S.)

	Note	December 31 2002	2001
CURRENT LIABILITIES			
Short-term bank credit and loans	(10)	$30,915	$ 46,894
Trade payables		83,463	108,617
Other payables and accrued expenses	(11)	142,526	135,386
Customers advances and amounts in excess of costs incurred	(12)	108,418	93,342
Total current liabilities		**365,322**	**384,239**
LONG-TERM LIABILITIES			
Long-term loans	(13)	73,173	69,202
Advances from customers	(12)	40,411	29,840
Deferred income taxes	(15)	16,413	21,989
Accrued severance pay	(14, 2M)	24,486	15,231
		154,483	**136,262**
CONTINGENT LIABILITIES AND COMMITMENTS	(16)		
MINORITY INTEREST		***4,675***	***2,931***
SHAREHOLDERS' EQUITY			
Share capital	(17)		
Ordinary shares of NIS 1 par value; authorized - 80,000,000 shares as of December 31, 2002 and 2001; Issued – 39,205,478 and 38,739,093 shares as of December 31, 2002 and 2001, respectively; Outstanding –38,796,657 and 38,330,272 shares as of December 31, 2002 and 2001, respectively		11,154	11,054
Accumulated other comprehensive loss		(2,882)	-
Additional paid-in capital		248,387	244,625
Retained earnings		159,023	126,627
Treasury stock- 408,821 shares as of December 31, 2002 and 2001		(4,321)	(4,321)
		411,361	**377,985**
		$935,841	**$ 901,417**

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S.dollars except for per share data)

	Note	For the year ended December 31 2002	2001	2000
Revenues	(18)	$827,456	$764,501	$ 591,084
Cost of revenues	(19)	605,313	553,957	432,786
Restructuring expenses (inventory write-off)		-	-	10,300
Gross profit		**222,143**	**210,544**	**147,998**
Research and development costs, net	(20)	57,010	58,759	44,274
Marketing and selling expenses	(21)	65,691	54,876	38,449
General and administrative expenses	(22)	41,651	43,216	26,251
Acquired in-process research and development		-	-	40,000
Restructuring costs		-	-	11,800
		164,352	**156,851**	**160,774**
Operating income (loss)		**57,791**	**53,693**	**(12,776)**
Financial income (expenses), net	(23)	(3,035)	(2,617)	115
Other income (expenses), net	(24)	(462)	774	3
Income (loss) before taxes on income		**54,294**	**51,850**	**(12,658)**
Taxes on income	(15)	9,348	11,003	6,227
		44,946	**40,847**	**(18,885)**
Equity in net (losses) earnings of affiliated companies and partnerships		675	(598)	(1,429)
Minority interest in losses (gains) of subsidiaries		(508)	547	(217)
Net income (loss)		**$45,113**	**$40,796**	**$(20,531)**
Earnings (loss) per share	(17)			
Basic net earnings (loss) per share		**$1.17**	**$ 1.07**	**$ (0.65)**
Diluted net earnings (loss) per share		**$1.13**	**$ 1.04**	**$ (0.65)**

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands of U.S.dollars except share data)

	Numbe of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive	Retained earnings	Treasury shares equity	Total Share-holders' equity	Total comprehensive income (loss)
Balance as of January 1, 2000	**25,422,396**	**$7,883**	**$52,687**	**-**	**$127,924**	**$(3,613)**	**$181,891**	**-**
Issuance of shares- in respect of merger with El- Op	12,100,000	2,963	177,037	-	-	-	180,000	-
Exercise of options	289,002	70	810	-	-	-	880	-
Tax benefit in respect of options exercised	-	-	889	-	-	-	889	-
Capital reserve in respect of issuance of shares by development stage investees	-	-	3,874	-	-	-	3,874	-
Amortization of stock compensation	-	-	155	-	-	-	155	-
Dividend Paid	-	-	-	-	(9,430)	-	(9,430)	-
Net Loss	-	-	-	-	(20,531)	-	(20,531)	(20,531)
Balance as of *December 31, 2000*	**37,811,398**	**10,916**	**235,462**	**-**	**97,963**	**(3,613)**	**340,728**	**-**
Exercise of options	585,860	138	3,162	-	-	-	3,300	-
Tax benefit in respect of options exercised	-	-	1,363	-	-	-	1,363	-
Adjustment to capital reserve	-	-	(3,874)	-	-	-	(3,874)	-
Amortization of stock compensation	-	-	8,512	-	-	-	8,512	-
Purchase of treasury shares	(66,986)	-	-	-	-	(708)	(708)	-
Dividend Paid	-	-	-	-	(12,132)	-	(12,132)	-
Net income	-	-	-	-	40,796	-	40,796	40,796
Balance as of *December 31, 2001*	**38,330,272**	**$11,054**	**$244,625**	**-**	**$126,627**	**$(4,321)**	**$377,985**	**40,796**
Exercise of options	466,385	100	4,040	-	-	-	4,140	-
Tax benefit in respect of options exercised	-	-	648	-	-	-	648	-
Amortization of stock compensation	-	-	(926)	-	-	-	(926)	-
Dividend Paid	-	-	-	-	(12,717)	-	(12,717)	-
Net income	-	-	-	-	45,113	-	45,113	45,113
Minimum pension liability	-	-	-	(2,882)	-	-	(2,882)	(2,882)
Balance as of *December 31, 2002*	**38,796,657**	**$11,154**	**$248,387**	**$(2,882)**	**$159,023**	**$(4,321)**	**$411,361**	**$42,231**

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

	Year ended December 31		
	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	**$45,113**	**$40,796**	**$(20,531)**
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	32,937	32,865	20,663
Amortization of deferred stock compensation	(926)	8,512	155
Acquired in-process research and development	-	-	40,000
Deferred income taxes	(5,620)	(2,694)	(6,482)
Severance pay fund	(113)	167	(1,196)
Increase (decrease) in provision for severance pay	6,373	(800)	9,266
Gain (loss) on disposal of property and equipment	743	(327)	(575)
Tax benefit in respect of options exercised	648	1,363	889
Other adjustments	683	(117)	(921)
Minority interests in gains (losses) of subsidiaries	508	(547)	217
Equity in net losses (earnings) of affiliated companies and partnerships	(675)	598	1,429
Changes in operating assets and liabilities:			
Decrease (increase) in trade receivables, other receivables and prepaid expenses	58,554	(9,963)	(18,975)
Increase in inventories	(55,106)	(72,165)	(25,228)
Increase (decrease) in trade payable and accrued expenses	(19,321)	37,004	(3,520)
Increase (decrease) in advances received from customers	42,999	6,489	(10,632)
Chief Scientist	9,197	-	-
Net cash provided by (used in) operating activities	**115,994**	**41,181**	**(15,441)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment and other assets	(46,003)	(45,244)	(40,374)
Investment grants received for property, plant and equipment	119	1,334	1,533
Acquisition of subsidiaries and activities (Schedule A)	(5,280)	(3,344)	14,133
Investments in affiliated companies and subsidiaries	(1,681)	(801)	(13,126)
Proceeds from sale of property, plant and equipment and investments	956	3,010	1,279
Long-term loan granted	(714)	-	-
Short-term loan repaid	1,371	-	-
Long-term bank deposits paid	(1,228)	(1,872)	(2,042)
Long-term bank deposits repaid	1,689	2,322	23,419
Short-term bank deposits, net	(204)	(57)	(638)
Net cash used in investing activities	**(50,975)**	**(44,652)**	**(15,816)**

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (cont.)

(In thousands of U.S. dollars)

	Year ended December 31		
	2002	**2001**	**2000**
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of convertible debentures	-	-	(283)
Proceeds from exercise of options	4,140	3,300	787
Repayment of long-term credit for purchase of a building	-	(3,000)	(10,000)
Purchase of treasury stock	-	(708)	-
Repayment of long-term bank loans	(3,249)	(13,049)	(1,852)
Proceeds from long-term bank loans	2,233	25,444	33,933
Dividends paid	(12,717)	(12,132)	(9,430)
Change in short-term bank credit and loans	(19,729)	(6,517)	32,321
Net cash provided by (used in) financing activities	**(29,322)**	**(6,662)**	**45,476**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**35,697**	**(10,133)**	**14,219**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**40,583**	**50,716**	**36,497**
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$76,280**	**$40,583**	**$50,716**
SUPPLEMENTARY CASH FLOWS ACTIVITIES:			
Cash paid during the year for:			
Income taxes	**$ 21,730**	**$ 9,469**	**$ 9,360**
Interest	***$ 2,947***	***$ 6,649***	***$ 7,645***
NON CASH TRANSACTIONS			
Debentures converted into shares	**$-**	**$-**	**$93**
SCHEDULE A:			
Subsidiaries and activities acquired (*)			
Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows:			
Working capital deficiency (working capital) (excluding cash and cash equivalents)	$ -	$888	$(39,805)
Property, plant and equipment	(275)	(1,886)	(80,493)
Know-how and other intangible assets	(5,078)	(3,800)	(53,000)
Goodwill and assembled work-force	-	-	(31,139)
In-process research and development	-	-	(40,000)
Long-term liabilities	-	1,454	76,224
Purchase of investments in credit	73	-	-
	(5,280)	**(3,344)**	**(168,213)**
Investment in subsidiary prior to consolidation	-	-	2,346
Less - amounts acquired by issuance of shares	-	-	180,000
	$(5,280)	**$(3,344)**	**$14,133**

* El-Op in 2000 (see note 1C); AEL in 2001 (see note 1F); Defense systems division of Elron Telesoft in 2002 (see note 1G).

The accompanying notes are an integral part of the financial statements.

Note 1 – GENERAL

A. Elbit Systems Ltd. (the "Company") is an Israeli corporation, 31% owned by the Federmann Group and 20% owned by Elron Electronic Industries Ltd. ("Elron"). The Company's shares are traded on the Tel Aviv Stock Exchange and on the NASDAQ National Market in the United States. The Company and its subsidiaries (the "Group") are engaged mainly in the field of defense electronics. The Company's principal wholly-owned subsidiaries are EFW Inc. ("EFW") and El-op Electro-Optics Industries Ltd. ("El-Op").

B. A majority of the Group's revenues were derived in recent years from direct or indirect sales to governments or to government agencies. As a result, a substantial portion of the Group's sales is subject to the special risks associated with sales to governments or to government agencies. These risks include, among others, the dependency on the resources allocated by governments to defense programs, changes in governmental priorities and changes in governmental approvals regarding export licenses required for the Group products and for its suppliers.

C. In 2000, the Company completed its merger with El-Op and issued 12,100,000 ordinary shares to El-Op shareholders. The purchase price based on the market value of the shares amounted to $180,000.

The merger was accounted for as a purchase and accordingly the purchase price was allocated to the fair value of assets acquired and liabilities assumed of El-Op.

El-Op is engaged primarily in the production and sales of military products and systems in the electro-optical and electro-mechanical sectors.

The excess of the purchase price over the fair value of the net tangible assets acquired ("excess of cost"), in the amount of $109,000 was allocated, based primarily on an independent appraisal, as follows: $40,000 was allocated to in-process research and development ("R&D") which was charged to operations upon completion of the merger; $58,000 was allocated to know-how ($45,000), trademarks ($8,000) and assembled work-force ($5,000); $18,200 was recorded as a deferred tax liability in respect of the differences between the allocation of the aforementioned assets and their tax basis and the balance, amounting to $29,200 was allocated to goodwill. These intangible assets are included in other assets in the consolidated balance sheet and are amortized over a period of 17 – 20 years, (except for goodwill and assembled work-force which commencing January 1, 2002 are no longer amortized - See Note 9). The Company began consolidating El-Op from the third quarter of 2000.

At the merger date, El-Op was conducting design, development, engineering and testing activities associated with the completion of numerous projects aimed at developing next-generation technologies that were expected to address emerging market demands in defense and commercial markets. The value assigned to these assets was determined by identifying significant research projects for which technological feasibility had not been established, including development, engineering and testing activities associated with the following areas: thermal imaging (night vision); lasers; avionics; battlefield management; fire control systems; remote sensing; airborne/space photography; enhanced landing systems; and other classified projects for the U.S. and Israeli governments.

Note 1 – GENERAL (Cont.)

C. (Cont.)

The nature of the efforts to develop the acquired in-process technology into commercially viable products principally relates to the completion of all planning, designing, prototyping, high-volume verification and testing activities that are necessary to establish that the proposed technologies meet their design specifications including functional, technical and economic performance requirements.

In making its purchase price allocation, management considered present value calculations of income, an analysis of project accomplishments and remaining outstanding items and an assessment of overall contributions as well as project risks. The value assigned to purchased in-process technology was determined by estimating the costs to develop the acquired technology into commercially viable products, estimating the resulting net cash flows from the projects, and discounting the net cash flows to their present value. The revenue projection used to value the in-process R&D was based on estimates of relevant market sizes and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by the Company and its competitors. The resulting net cash flows from such projects are based on management's estimates of cost of sales, operating expenses and income taxes from such projects.

Aggregate revenues for the developmental El-Op products were estimated to grow at a compounded annual growth rate of approximately 30 percent for the five years following introduction, assuming the successful completion and market acceptance of the major R&D programs. The estimated revenues for the in-process projects were expected to peak within five to six years of acquisition and then decline as other new products and technologies are expected to enter the market.

The estimated costs of goods sold and operating expenses as a percentage of revenues are expected to be lower than El-Op's on a stand-alone basis primarily due to production efficiencies expected to be achieved through economies of scale of the combined operations. As a result of these savings, the combined company has the possibility of achieving slightly higher margins in future periods.

The rates utilized to discount the net cash flows to their present value were based on estimated cost of capital calculations. Due to the nature of the forecast and the risks associated with the projected growth and profitability of the developmental projects, a discount rate of 18 to 20 percent was considered appropriate for the in-process R&D. These rates are higher than the Company's overall weighted average cost of capital due to the inherent uncertainties surrounding the successful development of the purchased in-process technology, the useful life of such technology and the uncertainty of technological advances that are unknown at this time.

If none of the acquired R&D projects is successfully developed, the sales and profitability of the combined company may be adversely affected in future periods. The failure of any particular individual project in-process would not likely impact the Company's financial condition, results of operations or the attractiveness of the overall El-Op investment. Financial results will be subject to uncertain market events and risks, which are beyond the Company's control, such as trends in technology, government spending, market size and growth and product introduction or other actions by competitors.

Note 1 – GENERAL (Cont.)

C. (Cont.)

The following unaudited proforma data is based on historical financial statements of the Company and El-Op and is provided for comparative purposes only. The proforma information does not purport to be indicative of the results that actually would have occurred had the merger agreement been consummated prior to the beginning of the reported periods.

The proforma information reflects the results of the Company's operations assuming that the merger had been in effect as of January 1, 2000 and under the following assumptions:

1. Goodwill and other intangible assets arising from the merger of approximately $83,000, is amortized over an average period of 17 years.
2. Excess of cost over equity purchased allocated to real estate assets of approximately $25,000, is amortized over a period of 25 years.
3. Deferred income taxes of approximately $18,000 have been recorded in respect of the differences between the allocated value of the aforementioned assets and their tax basis.
4. The cost attributed to purchased in-process R&D projects, in the amount of approximately $40,000 has been charged to operations immediately as a non-recurring item and is not included in the proforma consolidated results.
5. Intercompany balances and material transactions have been eliminated.
6. Management fees of approximately $3,000 per annum, which pursuant to the merger agreement would not be paid in the future, were eliminated in the proforma statements.

	Year ended December 31, 2000 (unaudited)
Revenues - proforma	$699,114
Net loss as reported	$(20,531)
Adjustments:	
Elimination of the charge to operations for purchased in-process research and development	40,000
Other adjustments, net	(2,570)
Net income - proforma (1)(2)	**$16,899**
Basic net earnings per share - proforma	**$0.45**
Diluted net earnings per share - proforma	**$0.44**

(1) The proforma net income for the year ended December 31, 2000 includes restructuring expenses, net of taxes, in the amount of $16,800.

(2) Included amortization of goodwill and assembled work force in the amount of approximately $1,100 which as of January 1, 2002 are no longer being amortized.

Note 1 – GENERAL (Cont.)

D. In 2000, EFW acquired the assets and the activities of Honeywell Inc. relating to head-up displays and tracking systems for helmets in consideration for $14,000. The excess of the purchase price over the fair value of identified net tangible assets acquired, in the amount of $11,100, was allocated to technology and other identifiable intangible assets ($9,300), to be amortized over a period of 15 years and to goodwill ($1,800).

Pro forma information in accordance with statement of financial accounting standards SFAS No. 141 has not been provided, since the revenues and net income of the Honeywell Inc. head-up display tracking business were not material in relation to total consolidated revenues and net loss.

E. In the third quarter of 2000, the Company commenced a program of restructuring its business, improving efficiency and reducing expenses. The program consisted of the consolidation of redundant activities, reduction of workforce, elimination of excessive inventories and equipment and other related actions. The program was accounted in accordance with EITF Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs in a Restructuring)", SAB-100, "Restructuring and Impairment Charges" and SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". Pursuant to the program, the Company wrote-off inventories in the amount of $10,300 and equipment in the amount of $5,100. The equipment will not be used in the future by the Company as this equipment is less efficient than other equipment held by the Company.

Through December 31, 2001, the Company paid $3,500 as part of its restructuring plan. The amount includes payments made to consultants, travel and other out-of-pocket expenses.

In addition, the Company accrued and paid $3,200 for employee severance benefits. The Company's plan included termination of the employment of a total of 61 manufacturing, marketing and corporate employees both in Israel and in the U.S.

F. In 2001, the Company acquired a 62.5% interest in Aeroeletronica - Industrial de Componentes Avionicos S.A. ("AEL"), a Brazilian company located in Porto Alegre, for approximately $3,450. In July 2002, the Company acquired the remaining 37.5% interest for an additional $900. The consideration paid includes approximately $1,200 (in cash) held in escrow, pending final resolution of certain liabilities and contingencies of AEL to be resolved over a period of five years following the acquisition. The excess of cost over equity purchased of approximately $6,700 was allocated to land ($1,200) and identifiable intangible assets ($5,500), to be amortized over a period of 8 years.

AEL serves as a center for the production and logistics support of defense electronics for programs in Brazil

The results of AEL's operations have been included in the consolidated financial statements from the date of purchase.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of AEL were not material in relation to total consolidated revenues and net income .

Note 1 – GENERAL (Cont.)

G. In January 2002, the Company acquired from Elron Telesoft Inc. and its subsidiaries ("Elron Telesoft") the assets and the activities of the Defense Systems Division of Elron Telesoft ("the Government Division") in consideration for $5,700. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $5,100 was allocated to technology and other intangible assets to be amortized over an average period of 3 years.

The Government Division is engaged mainly in the development of communication systems, information technology and image intelligence processing for defense and military applications.

The results of the Government Division have been included in the consolidated financial statements from the first quarter of 2002.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of the Government Division were not material in relation to total consolidated revenues and net income .

Note 2 – SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP"). As applicable to the financial statements of the Company, such principles are substantially identical to accounting principles generally accepted in Israel, except as described in Note 26.

A. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Actual results could differ from those estimates.

B. FINANCIAL STATEMENTS IN U.S. DOLLARS

The Company revenues are generated mainly in U.S. dollars. In addition, most of the Company's costs are incurred in U.S. dollars. Company's management believes that the U.S. dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the U.S. dollar.

Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transaction and balances in other currencies have been remeasured into U.S. dollars in accordance with principles set forth in SFAS No. 52.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. FINANCIAL STATEMENTS IN U.S. DOLLARS (Cont.)

Accordingly items have been remeasured as follows:

Monetary items – at the exchange rate in effect on the balance sheet date.

Nonmonetary items – at historical exchange rates.

Revenue and expense items - at the exchange rates in effect as of the date of recognition of those items (excluding depreciation and other items deriving from non-monetary items).

All exchange gain and losses from the remeasurement mentioned above are reflected in the statement of operations in financial income or expenses.

Balances linked to the Consumer Price Index in Israel ("CPI") are stated using the relevant published index.

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries.

The consolidated subsidiaries include El-Op, EFW and other Israeli and non - Israeli subsidiaries.

Intercompany transactions and balances including profit from intercompany sales not yet realized outside the Group have been eliminated upon consolidation.

D. CASH AND CASH EQUIVALENTS

All short-term highly liquid investments with an original maturity of three months or less are considered cash equivalents.

E. SHORT-TERM BANK DEPOSITS

Short-term bank deposits are disposits with maturities of more than three months but less than one year. The short–term bank deposits are presented at their cost.

F. INVENTORIES

Inventories are stated at the lower of cost or net realizable value. Inventory write-offs are provided for slow-moving items or technological obsolescence for which recoverability is not probable.

Cost is determined as follows:

- Raw materials, parts and supplies using the average cost method.
- Costs on long-term contracts represent recoverable costs incurred for production, allocable operating overhead and, where appropriate, research and development costs.

Advances from customers are allocated to the applicable contract inventories and are reflected as an offset against the related inventory balances.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

G. INVESTMENT IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES

Investments in non-marketable shares of companies in which the Group holds less than 20% and the Group does not have the ability to exercise significant influence over operating and financial policies of the companies are recorded at the lower of cost or estimated fair value.

Investments in companies and partnerships over which the Group can exercise significant influence (generally, entities in which the Group holds between 20% and 50% of voting rights) are presented using the equity method of accounting. The Group generally discontinues applying the equity method when its investment (including advances and loans) is reduced to zero and it has not guaranteed obligations of the affiliate or otherwise committed to provide further financial support to the affiliate.

In certain investments, the Group applies EITF 99-10, "Percentage Used to Determine the Amount of Equity Method Losses", according to which the Company recognizes equity method losses based on the ownership level of the particular investee security or loan held by the company to which the equity method losses are being applied.

Management evaluates investments in affiliates, partnership and other companies for evidence of other than temporary declines in value. When relevant factors indicate a loss in value that is other than temporary, the Company records a provision for the decline in value.

H. LONG-TERM TRADE RECEIVABLES

Long-term trade receivables from extended payment agreements are recorded initially at their estimated present values (determined based on the original rates of interest). Imputed interest is recognized using the effective interest method and is included as a component of interest income in the accompanying statements.

I. LONG-TERM BANK DEPOSITS

Bank deposits with maturities of more than one year are presented at cost including accumulated interest.

J. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment are stated at cost, net of accumulated depreciation and investment grants. For equipment produced for the Group's own use, cost includes materials, labor and overhead, but not in excess of the fair value of replacement equipment. Depreciation is calculated by the straight-line method over the estimated useful life of the assets at the following annual rates:

	%	
Buildings	2 - 4	(mainly 4%)
Instruments, machinery and equipment	10 - 33	
Office furniture and other	6 - 33	
Motor vehicles	15 - 33	(mainly 15%)

Land rights and leasehold improvements - over the term of the lease.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

K. IMPAIRMENT OF LONG-LIVED ASSETS

The Company's long-lived assets and certain identifiable intangible assets are reviewed for impairment in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed its fair value.

L. OTHER ASSETS

Other assets include mainly goodwill, know-how and trademarks acquired in connection with the purchase of subsidiaries and activities. Know-how and trademarks are amortized over their estimated useful lives using the straight-line method.

Goodwill represents excess of the cost of acquired entities over the net of the amounts assigned to assets acquired and liabilities assumed. Goodwill that arose from acquisitions prior to July 1, 2001, was amortized until December 31, 2001, on a straight-line basis over 10 - 20 years. Under SFAS No. 142, "Goodwill and Other Intangible Assets", such goodwill shall no longer be amortized effective as of January 1, 2002.

SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value exceeds the fair value, impairment is measured by comparing the implied fair value of goodwill to its carrying value. Fair value of a reporting unit is determined using discounted cash flows. Significant estimates used in the methodology include estimates of future cash flows, further short-term and long-term growth rates and weighted average cost of capital for each of the reportable units.

The adoption of SFAS 142 did not affect the financial position and results of operations of the Group as of January 1, 2002.

M. SEVERANCE PAY

Under Israeli law and employment agreements, the Group's companies in Israel are required to make severance payments and, in certain situations, pay pensions to terminated employees. The calculation is based on the employee's latest salary and the period of his employment. The companies' obligation for severance pay and pension is provided by monthly deposits with insurance companies, pension funds and by an accrual.

The value of severance pay funds is presented in the balance sheet and includes profits accumulated to balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds are based on the cash surrendered value of these funds and include immaterial profits.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

M. SEVERANCE PAY (Cont.)

Severance pay expenses for the years ended December 31, 2000, 2001 and 2002, amounted to approximately $5,591, $8,097 and $10,138, respectively.

N. REVENUE RECOGNITION

The Company generates revenues from long-term contracts involving the design, development, manufacture and integration of defense systems and products and providing support and services for such systems and products. Revenues from long-term contracts are recognized based on SOP 81-1 "Accounting for Performance of Construction-Type and Certain Production - Type Contracts" on the percentage of completion method.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage of completion basis, generally using units of delivery as the measurement basis for effort accomplished. Estimated contract profit is included in earnings in proportion to recorded sales.

Sales under certain long-term fixed-price contracts which, among other things require a significant amount of development effort in relation to total contract value, are recorded using the cost-to-cost method of accounting where sales and profit are recorded based on the ratio of costs incurred to estimated total costs at completion but not before the Company achieves certain milestones.

Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance.

Anticipated losses on contracts are charged to earnings when identified.

The Company estimates the costs that may be incurred under its basic warranty and records a liability in the amount of such costs at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold and the country in which the Company does business. Factors that affect the Company's warranty liability include the number of delivered units, engineering estimates and anticipated rates of warranty claims. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

O. RESEARCH AND DEVELOPMENT COSTS

Research and development costs, net of participations, are charged to operations as incurred.

Group sponsored research and development costs primarily include independent research and development and bid and proposal efforts.

Under certain arrangements in which a customer shares in product development costs, the Group's portion of such unreimbursed costs is expensed as incurred. Customer-sponsored research and development costs incurred pursuant to contracts are accounted for as contract costs.

Certain group companies in Israel receive royalty-bearing grants from the Government of Israel and from other sources for the purpose of funding approved research and development projects. These grants are recognized at the time the applicable company is entitled to such grants on the basis of the costs incurred and are presented as a deduction from research and development costs.

P. INCOME TAXES

The Group accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

Q. CONCENTRATION OF CREDIT RISKS

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, short-term and long-term deposits, trade receivables and long-term receivables.

The majority of the Group's cash and cash equivalents is invested in dollar instruments with major banks in Israel and in the U.S. Management believes that the financial institutions that hold the Group investments are financially sound and accordingly, minimal credit risk exists with respect to these investments.

The Group's trade receivables are derived primarily from sales to large and solid customers and governments located mainly in Israel, the United States and Europe. The Group performs ongoing credit evaluations of its customers and to date, has not experienced any unexpected material losses except for a one time loss in 2002 of approximately $4,600 due to the insolvency of one of the Group's customers. An allowance for doubtful accounts is determined with respect to those amounts that the Group has determined to be doubtful of collection and by a general reserve.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

R. DERIVATIVE FINANCIAL INSTRUMENTS

The Group accounts for derivatives and hedging based on SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 requires the Company to recognize all derivatives on the balance sheet at fair value. If the derivative meets the definition of a hedge and is so designated, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is recognized in earnings.

For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

The Company enters into forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. The purpose of the Company's foreign currency hedging activities is to protect the Company from risk that the eventual dollar cash flows from the sale of products to international customers will be adversely affected by changes in the exchange rates.

In addition, in order to ensure the dollar value of certain assets and liabilities, the Group has entered into forward exchange contracts.
As of December 31, 2002, the Group had contracts with notional value of approximately $21,400 to purchase and sell foreign currencies. These contracts mature in 2003.

The fair value of the foreign exchange contracts as of December 31 , 2002 amounted to $1,178.

S. STOCK-BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB 25") "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44 ("FIN 44") "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans. Under APB 25, compensation expense is recognized based on the intrinsic value method whereby compensation expense is equal to the excess if any of the quoted market price of the stock at the grant date of the award or other measurement date, over the amount an employee must pay to acquire the stock. The Company recognizes the expense over the vesting period of the award.

In respect of phantom share options the Company applies compensation accounting under SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, the Company is required to disclose pro forma information regarding stock based employee compensation cost net income (loss) and basic and diluted net income (loss) per share, as if the Company had accounted for its employee share options under the fair value method of SFAS 123. The fair value for these options was estimated at the grant date using a Black-Scholes option pricing model with the following weighted average assumptions for 2000, 2001 and 2002: risk-free interest rates of 6%, 2% and 1.34% respectively, dividend yields of 2.0%, 2.03% and 1.99% respectively, volatility of 49.5%, 33.8% and 21.2% respectively, and a weighted average expected life of the options of 6 years.

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

S. STOCK-BASED COMPENSATION (Cont.)

Pro forma informatiom under SFAS 123 is as follows:

	Year ended December 31		
	2002	2001	2000
Net income (loss) as reported	$ 45,113	$ 40,796	$ (20,531)
Stock based compensation as reported	(926)	8,512	155
Stock based compensation under SFAS 123	(3,695)	(3,665)	(730)
Pro forma net income (loss)	**$ 40,492**	**$ 45,643**	**$ (21,106)**
Basic net income (loss) per share as reported	**$ 1.17**	**$ 1.07**	**$ (0.65)**
Pro forma basic net income (loss) per share	**$ 1.05**	**$ 1.20**	**$ (0.67)**
Diluted net income (loss) per share as reported	**$ 1.13**	**$ 1.04**	**$ (0.65)**
Pro forma diluted net income (loss) per share	**$ 1.02**	**$ 1.16**	**$ (0.67)**

T. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount reported in the balance sheet for cash and cash equivalents, short-term deposits, trade receivables, other receivables, short-term bank loans, short-term trade payables and other payables approximate their fair values due to the short-term maturities of such instruments.

Long-term loans are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term loans approximates their fair value.

The fair value of foreign currency contracts (used for hedging purposes) is estimated by obtaining current quotes from investment bankers.

It was not practicable to estimate the fair value of the Company's investments in shares of non-public affiliates and other Companies because of the lack of a quoted market price and the inability to obtain valuation of each Company without incurring excessive costs. The carrying amounts of these Companies were $31,492 and $33,051 as of December 31, 2001 and 2002, respectively and represent the original cost and, in the case of affiliates, include the Company's equity in the earnings or losses of the affiliates since the dates of acquisition.

U. BASIC AND DILUTED NET EARNINGS (LOSS) PER SHARE

Basic net earnings (loss) per share is computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earning (loss) per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year. Outstanding stock options are excluded from the calculation of the diluted net earning (loss) per ordinary share when such securities are anti-dilutive. The total weighted average number of shares related to the outstanding options excluded from the calculation of diluted net loss per share was 647 for the year ended December 31, 2000 (2001 and 2002 – none).

Note 2 – SIGNIFICANT ACCOUNTING POLICIES (Cont.)

V. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses significant issues regarding the recognition, measurement and reporting of costs associated with exit and disposal activities, including restructuring activities. SFAS No. 146 requires that costs associated with exit or disposal activities be recognized when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is effective for all exit or disposal activities initiated after December 31, 2002. SFAS No. 146 also requires liabilities accrued in respect of such cost to be measured at fair value. The Company does not expect the adoption of SFAS No. 146 to have a material impact on its results of operations or financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34 ("FIN No.45"). FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN No. 45 does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. It also incorporates, without change, the guidance in FASB Interpretation No.34, "Disclosure of Indirect Guarantees of Indebtedness of Others", which is being superseded. The disclosure provisions of FIN No. 45 are effective for financial statements of interim or annual periods that end after December 15, 2002, and the provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The Company does not expect the adoption of FIN No. 45 to have a material impact on its results of operations or financial position.

W. RECLASSIFICATIONS

Certain financial statement data for prior years has been reclassified to conform with current year financial statement presentation.

Note 3 – TRADE RECEIVABLES, NET

A. Trade receivables

	December 31	
	2002	**2001**
Open accounts (*)	$177,465	$175,275
Unbilled receivables	53,670	69,752
Less - allowance for doubtful accounts	(3,411)	(3,200)
	$227,724	**$241,827**
***(*)* Includes affiliated companies**	**$9,647**	**$14,257**

B. Long-term trade receivables include amounts due to the Company in connection with certain contracts. The receivables are guaranteed by governmental authorities and their majority portion is insured by financial institutions. The receivables are denominated in U.S dollars, payable over a period of one and a half years and bear interest rates of Libor + 1.5%.

Note 4 – OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31	
	2002	**2001**
Prepaid expenses	$12,244	$13,445
Government departments	5,915	4,937
Employees	1,029	710
Deferred income taxes	11,675	11,631
Other	3,513	5,486
	$34,376	**$36,209**

Note 5 – INVENTORIES, NET OF ADVANCES

	December 31	
	2002	**2001**
Cost of long-term contracts in progress	$ 205,318	$155,712
Raw materials	75,579	70,133
Advances to suppliers and subcontractors	25,047	30,955
	305,944	**256,800**
Less -		
Cost of contracts in progress deducted from customer advances	10,658	10,961
	295,286	**245,839**
Less -		
Advances received from customers	67,624	49,969
Provision for losses	4,818	10,780
	$ 222,844	**$ 185,090**

(*) The Company has transferred legal title of inventories to certain customers as collateral for advances received.

Note 6 – INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIPS AND OTHER COMPANIES

A. Investments in companies accounted for under the equity method

	December 31	
	2002	**2001**
SCD (1)	$ 15,713	$ 13,036
VSI (2)	3,893	2,030
Red C (3)	-	2,549
Opgal (4)	2,028	1,894
Others (5)	313	74
	$ 21,947	**$ 19,583**

(1) Semi Conductor Devices ("SCD"), a partnership, held 50% by the Company and 50% by Rafael Armaments Development Authority Ltd. ("Rafael"). SCD is engaged in the development and production of various thermal detectors and laser diodes.

(2) Vision Systems International LLC ("VSI") based in San Jose, California is a limited liability company that is held 50% by EFW. VSI operates in the area of helmet mounted display systems for fixed wing military and paramilitary aircraft.

(3) Red C Optical Networks Inc. ("Red C") is engaged in the multi-focal optic communications sector and is held 36.5% by El-Op. Red C designs, develops and manufactures optical amplifiers for dense wave-length multiplexing (DWDM) optical networks for telecommunication renders. In 2002 the investment in Red C was written off.

Note 6 – INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIPS AND OTHER COMPANIES (Cont.)

(4) Opgal Optronics Industries ("Opgal") Ltd., is an Israeli company owned 50.1% by the Company and 49.9% by a subsidiary of Rafael. Opgal focuses mainly on commercial applications of thermal imaging and electro-optic technologies. The Company jointly controls Opgal with Rafael, and therefore Opgal is not consolidated in the Company's financial statements.

(5) Mediguide Inc. ("Mediguide") and its Israeli subsidiary, Mediguide Ltd., were established in 2000 as a spin-off from the Company, which holds the majority of Mediguide's ordinary shares. In 2001 and 2002, Mediguide issued preferred shares to other investors in consideration for approximately $6,000 based on a pre-money valuation of $14,000 - $17,000. The preferred shares entitle the other investors to preference rights in any liquidation event. Therefore, the Company did not record any gain as a result of the above transaction. In addition the preferred shares entitle their holders to certain participating rights. Accordingly based on the guidance in EITF 96-16, the Company ceased consolidating its investment in Mediguide and accounts for the investment in Mediguide under the equity method of accounting.

(6) See Note 16(E) for guarantees.

B. Investments in companies accounted for under the cost method

	December 31	
	2002	**2001**
Soltam (1)	$3,500	$3,500
ISI (2)	7,230	7,230
Other	374	1,179
	$11,104	**$11,909**

(1) Soltam Systems Ltd. ("Soltam"), held 10% by the Company, is engaged in the development and manufacturing of military systems in the artillery sector.

(2) ImageSat International N.V. ("ISI"), held 14% (10% on a fully diluted basis) by the Company, is engaged in the operation of satellite photography formations and commercial delivery of satellite photography for civil purposes.

Note 7 – LONG –TERM BANK DEPOSITS AND LOAN

	December 31	
	2002	**2001**
Deposits with bank for loans granted to employees (*)	$2,037	2,238
Other deposits with bank	935	1,195
Long-term loan	714	-
	$3,686	**$3,433**

* The deposits are linked to the Israeli CPI, bear annual interest of 4% and are presented net of current maturities of $680 (2001 - $746).

Note 8 – PROPERTY, PLANT AND EQUIPMENT, NET

	December 31	
	2002	**2001**
COST (1):		
Land, buildings and leasehold improvements (2)	$ 127,932	$ 114,690
Instruments, machinery and equipment (3)	167,105	145,114
Office furniture and other	24,790	22,093
Motor vehicles	24,393	19,715
	344,220	**301,612**
Accumulated depreciation	(141,259)	(116,890)
Depreciated cost	**$ 202,961**	**$ 184,722**

Depreciation expenses for the years ended December 31, 2000, 2001 and 2002 amounted to $24,177, $24,517 and $26,525 respectively.

(1) Net of investment grants received (mainly for instruments, machinery and equipment) in the amounts of approximately $38,300 and $38,420 as of December 31, 2001 and 2002, respectively. Cost includes assets fully depreciated and still in use in the amount of $124,000 and of $134,000 as of December 31, 2001 and 2002, respectively.

(2) Includes, rights in approximately 9,225 square meters of land in, Tirat Hacarmel Israel, of which approximately 2,300 square meters are owned while the remaining land is leased from the Israel Land Administration until the years 2014 to 2024 with an option to renew the lease for additional periods up to 49 years. The Company's rights in the land have not yet been registered in its name.

Includes, rights in approximately 10,633 square meters of land in Rehovot, Israel. The land is leased from the Israel Land Administration until the year of 2043 with an option to renew the lease for additional periods up to 49 years. The Company's rights in the land have not yet been registered in its name.

(3) Includes equipment produced by the Group for its own use in the amount of $4,913 and $5,517 as of December 31, 2001 and 2002, respectively.

(4) As for pledges of assets – see Note 16(G).

Note 9 – OTHER ASSETS, NET

A.

	Weighted-average number of years	December 31 2002	December 31 2001
Original cost:			
Know-how (1)	12.5	$81,019	$74,716
Trade marks (2)	17	8,000	8,000
Goodwill and assembled work-force (3)		37,578	36,983
		126,597	**119,699**
Accumulated amortization			
Know-how		14,666	8,704
Trade marks		1,125	675
Goodwill and assembled work-force		5,037	5,037
		20,828	**14,416**
Amortized cost		**$105,769**	**$105,283**

(1) Includes mainly know-how acquired in the merger with El-Op ($45,000), know-how acquired in the acquisition of AEL and the Government Division ($10,600) and intangible assets acquired from Honeywell Inc. ($9,300) (see Notes 1C, 1D, 1F and 1G)

(2) Includes trade marks acquired in the merger with El-Op.

(3) Includes mainly intangible assets acquired in the merger with El-Op ($34,200) and intangible assets acquired from Honeywell Inc. ($1,800). Until January 1, 2002, goodwill and assembled work-force were amortized at an annual rate of 5% - 10%.

B. Amortization expenses amounted to $5,401, $8,348 and $6,412 for the years ended December 31, 2000, 2001 and 2002, respectively.

C. The annual amortization expense relating to intangibles existing as of December 31, 2002 for each of the five years in the period ending December 31, 2007 is estimated to be approximately $7,000.

Note 9 – OTHER ASSETS, NET (Cont.)

The following information is presented to reflect net income and earnings per share for all prior periods adjusted to exclude amortization of goodwill.

	December 31	
	2001	**2000**
Reported net income (loss)	$ 40,796	$ (20,531)
Goodwill amortization	2,760	2,012
Adjusted net income (loss)	**$43,556**	**$(18,519)**
Reported basic earnings (loss) per share	$ 1.07	$ (0.65)
Goodwill amortization	0.08	0.06
Adjusted basic earnings per share	**$ 1.15**	**$ (0.59)**
Reported diluted earnings (loss) per share	$ 1.04	$ (0.65)
Goodwill amortization	0.07	0.06
Adjusted diluted earnings (loss) per share	**$ 1.11**	**$ (0.59)**

Note 10 – SHORT-TERM BANK CREDIT AND LOANS

			December 31	
	2002	**2001**	**2002**	**2001**
	Interest rate %			
Short-term bank loans:				
In U.S. dollars	3-5	2.5-3.3	$12,683	$12,922
In NIS unlinked	-	4.7-8	-	13,273
			12,683	**26,195**
Short-term bank credit:				
In NIS unlinked	2.8-10.9	8	5,241	1,869
In U.S. dollars	3.2-3.6	2-2.5	6,378	15,967
			11,619	**17,836**
Current maturities of long-term loans			6,613	2,863
			$30,915	**$46,894**

Note 11 – OTHER ACCOUNTS PAYABLES AND ACCRUED EXPENSES

	December 31	
	2002	**2001**
Payroll and related expenses	$ 27,912	$ 25,736
Provision for vacation pay	20,492	18,380
Government departments	22,443	28,750
Provision for warranty	26,641	22,723
Cost provisions and other	45,038	39,797
	$ 142,526	**$135,386**

Note 12 – CUSTOMERS' ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED

	December 31	
	2002	**2001**
Advances received	$ 227,111	$ 184,112
Less -		
Advances presented under long-term liabilities	40,411	29,840
Advances deducted from inventories	67,624	49,969
	119,076	**104,303**
Less -		
Costs of contracts in progress	10,658	10,961
	$ 108,418	**$ 93,342**

Note 13 – LONG-TERM LOANS

		Interest	Years of	December 31	
	Linkage	**%**	**maturity**	**2002**	**2001**
Banks	U.S. dollars	Libor + 0.5%-5%	2003 – 2007	$67,206	$70,719
Banks	NIS-unlinked	Israeli Prime	2003 – 2036	3,383	1,346
Office of Chief Scientist	NIS-linked to the Israeli-CPI	4%	2003 – 2006	9,197	-
			79,786	**72,065**	
Less-current maturities				6,613	2,863
				$73,173	**$69,202**

Note 13 – LONG-TERM LOANS (Cont.)

The Libor rate as of December 31, 2002 was 1.34%.

The Israeli Prime rate as of December 31, 2002 was 10.5%

The maturities of these loans after December 31, 2002 are as follows:

2003 – current maturities	$6,613
2004	54,278
2005	4,499
2006	4,506
2007	7,062
2008 and thereafter	2,828
	$ 79,786

In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees securing certain advances from customers, the Company and certain subsidiaries are obligated to meet certain loan covenants. Management believes that the Company and the subsidiaries meet the conditions of these covenants as of balance sheet date.

Note 14 – BENEFIT PLANS

Retirement Benefits:

Subsidiaries in the U.S. sponsor defined benefit retirement plans ("Plans") which are noncontributory plans, covering substantially all of the U.S. employees, that provide monthly pension to eligible employees upon retirement, in amounts based on years of service and average compensation.

The following table reconciles the benefit obligations, Plans assets, funded status and net asset (liability) information of the Plans:

	December 31	
	2002	**2001**
Benefit obligation at beginning of year	$22,358	$18,474
Service cost	2,067	1,766
Interest cost	1,678	1,461
Actuarial losses	2,955	1,338
Benefits repaid	(619)	(681)
Benefit obligation at end of year	**28,439**	**22,358**

Note 14 – BENEFIT PLANS (Cont.)

	December 31	
	2002	**2001**
Plans assets at beginning of year	16,167	17,846
Actual return on plan assets	(1,560)	(1,121)
Contributions by employer	1,571	123
Benefits repaid	(619)	(681)
Plans assets at end of year	**15,559**	**16,167**
Funded status of Plans (underfunded)	(12,880)	(6,191)
Unrecognized prior service cost	234	223
Unrecognized net actuarial loss	7,582	1,508
Net amount recognized	**(5,064)**	**(4,460)**
Net asset (liability) consists of:		
Accrued benefit liability	(10,298)	(4,667)
Intangible assets	234	207
Accumulated other comprehensive income	5,000	-
Net amount recognized	**$(5,064)**	**$(4,460)**
Weighted average assumptions :		
Discount rate as of December 31,	6.75%	7.38%
Expected long-term rate of return on Plans assets	9.00%	9.50%
Rate of compensation increase	3.00%	3.00%

	Year ended December 31		
	2002	**2001**	**2000**
Components of net periodic pension cost:			
Service cost	$2,067	$1,766	$1,904
Interest cost	1,678	1,461	1,253
Expected return on Plan assets	(1,597)	(1,666)	(1,680)
Amortization of prior service cost	28	24	25
Recognized of net actuarial gain	(340)	(38)	(312)
One-time FAS 88 charge for 2001 SRP	-	177	-
Net periodic pension cost	**$1,836**	**$1,724**	**$1,190**

Note 14 – BENEFIT PLANS (Cont.)

Defined Contribution Plan

The 401(k) savings plan ("401(k) plan") is a defined contribution retirement plan that covers all eligible employees, as defined in section 401(k) of the U.S. Internal Revenue Code. Employees may elect to contribute a percentage of their annual gross compensation to the 401(k) plan. The Company may make discretionary matching contributions as determined by the Company. Total expense under the 401(k) plan amounted to $1,369 for the year ended December 31, 2002 (2001 - $639).

Note 15 – INCOME TAXES

A. APPLICABLE TAX LAWS

(1) Measurement of taxable income under Israel's Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured and reflected in accordance with the change in the Israeli Consumer Price Index ("CPI"). As explained above in Note 2B, the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/ U.S. dollar exchange rate cause a difference between taxable income and the income before taxes reflected in the consolidated financial statements.

In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the above difference between the reporting currency and the tax basis of assets and liabilities.

(2) Tax benefits under Israel's Law for the Encouragement of Industry (Taxes), 1969:

The Company and certain subsidiaries (mainly El-Op and Cyclone) are "Industrial Companies", as defined by the Law for the Encouragement of Industry (Taxes), 1969, and as such, these Companies are entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years, accelerated depreciation and the right to deduct for tax purposs public issuance expenses.

(3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959:

Three expansion programs of the Company have been granted "Approved Enterprise" status under Israel's Law for the Encouragement of Capital Investments, 1959. For these expansion programs, the Company has elected to receive grants. Accordingly the income of the Company derived from the "Approved Enterprise" expansion programs is tax exempt for two-year period and subject to reduced tax rates of 25% for five-year period commencing in the year in which the Company first generates taxable income (limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier). As of December 31, 2002, the tax benefits for these expansion programs will expire between 2002 to 2007.

Three expansion programs of El-Op have been granted, such "Approved Enterprise" status. For these expansion programs, El-Op has elected the alternative tax benefits track. In this track the income of El-Op derived from the "Approved Enterprise" expansion programs is tax exempt for a two-year period and subject to reduced tax rates of 25% for a five-year period commencing in the year which the company first generates taxable income (limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier). As of December 31, 2002, the tax benefits for these expansion programs will expire between 2003 to 2005.

Note 15 – INCOME TAXES (Cont.)

A. APPLICABLE TAX LAWS (Cont.)

(3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959: (Cont.)

The entitlement to the above benefits is subject to the companies fulfilling the conditions specified in the above refereed law, regulations published thereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the companies may be required to refund the amount of the benefits, in whole or in part, including interest. (For liens – see Note 16F). As of December 31, 2002, management believes that the companies are meeting all conditions of the approvals.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without imposing tax liability on the companies only upon the complete liquidation of the companies. As of December 31, 2002, retained earnings included approximately $74,000 in tax-exempt profits earned by the Group's "Approved Enterprise". The Company's Board of Directors has decided that its policy is not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

If the retained tax-exempt income is distributed in a manner other than on the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected alternative tax benefits (currently - 25%) and an income tax liability would be incurred of approximately $ 19,000 as of December 31, 2002.

Income from sources other then the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate of 36%.

Since the Company and El-Op are operating under more than one approval, and since part of their taxable income is not entitled to tax benefits under the abovementioned law and is taxed at the regular tax rate of 36%, the effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each approval on the basis of formulas specified in the law and in the approvals.

B. TAX ASSESSMENTS

1. The Company and El-Op have received final tax assessments through December 31, 2000. EFW has received final tax assessments through December 31, 1997.

2. The Company and El-Op have received in previous years pre-rulings from the tax authorities, which allowed them to transfer development products and assets to companies under their ownership without any tax liability pursuant to section 104 of the Israeli Income Tax Ordinance. The pre-rulings specify terms for the companies to comply, usually for a two - year period. Non-compliance with the terms of the pre-rulings will result in the retroactive cancellation of the aforementioned exemption from taxes. Tax implications upon non-compliance are estimated by management to be immaterial to the Group's results.

Note 15 – INCOME TAXES (Cont.)

C. NON – ISRAELI SUBSIDIARIES

Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence (mainly in the U.S.).

D. INCOME (LOSS) BEFORE TAXES ON INCOME

	Year ended December 31		
	2002	**2001**	**2000**
Income (loss) before taxes on income income:			
Domestic	$42,317	$44,212	$(13,779)
Foreign	11,977	7,638	1,121
	$54,294	**$51,850**	**$(12,658)**

E. TAXES ON INCOME

Taxes on income:			
Current taxes:			
Domestic	$11,654	$9,385	$8,710
Foreign	6,114	3,048	879
	17,768	**12,433**	**9,589**
Deferred income taxes:			
Domestic	(3,561)	(839)	(5,309)
Foreign	(2,059)	(591)	1,947
	(5,620)	**(1,430)**	**(3,362)**
Taxes in respect of prior years	(*)(2,800)	-	-
	$9,348	**$11,003**	**$6,227**

(*) A reduction of tax expenses due to adjustments of estimated taxes and completion of tax assessments for prior years in respect of various Group companies.

Note 15 – INCOME TAXES (Cont.)

F. DEFERRED INCOME TAXES

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of net deferred tax assets and liabilities are as follows:

		Deferred tax asset (liability)(1)	
	Total	**Current**	**Non-current**
As of December 31, 2002			
Deferred tax assets:			
Reserve and allowances	$12,770	$4,797	$7,973
Inventory	6,878	6,878	-
Net operating loss carryforwards	2,326	-	2,326
Valuation allowance (2)	(2,326)	-	(2,326)
Net deferred tax assets	**19,648**	**11,675**	**7,973**
Deferred tax liabilities:			
Property, plant and equipment	(9,209)	-	(9,209)
Other assets	(15,177)	-	(15,177
	(24,386)	**-**	**(24,386)**
Net deferred tax assets (liabilities)	**$ (4,738)**	**$11,675**	**$ (16,413)**
As of December 31, 2001			
Deferred tax assets:			
Reserve and allowances	$ 9,067	$ 4,308	$ 4,759
Inventory	7,323	7,323	-
Net operating loss carryforwards	4,248	-	4,248
Valuation allowance (2)	(2,202)	-	(2,202)
Net deferred tax assets	**18,436**	**11,631**	**6,805**
Deferred tax liabilities:			
Property, plant and equipment	(12,111)	-	(12,111)
Other assets	(16,683)	-	(16,683)
	(28,794)	**-**	**(28,794)**
Net deferred tax assets (liabilities)	**$(10,358)**	**$11,631**	**$(21,989)**

(1) Current tax asset is included in other receivables. Non-current tax liability is included as a long-term liabilitiy.

(2) During 2002, the Company increased the valuation allowance due to an increase in accumulated operating loss carryforwards not expected to be utilized.

Note 15 – INCOME TAXES (Cont.)

G. The Company's Israeli subsidiaries have estimated total available carryforward tax losses of approximately $2,200 as of December 31, 2002, . The Company's non-Israeli subsidiaries have estimated available carryforward tax losses of approximately $200 as of December 31 2002 to offset against future taxable profits for an indefinite period. Deferred tax assets in respect of the above carryforward losses amount to approximately $2,400 in respect of which a valuation allowance has been recorded in the amount of approximately $2,400.

H. Reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Company, and the actual tax expense as reported in the statements of operations, is as follows:

	Year ended December 31		
	2002	**2001**	**2000**
Income (loss) before taxes as reported in the consolidated statements of operations	$54,294	$51,850	$(12,658)
Statutory tax rate	36%	36%	36%
Theoretical tax expense (benefit)	$19,546	$18,666	$(4,557)
Tax benefit arising from reduced rate as an "Approved Enterprise"	(9,054)	(7,697)	4,015)
Tax adjustment in respect of different tax rate for foreign subsidiaries	(461)	(952)	(469)
Operating carryforward losses for which valuation allowance was provided	2,189	101	318
Increase (decrease) in taxes resulting from nondeductible expenses	(263)	571	15,280
Difference in basis of measurement for financial reporting and tax return purposes	458	832	(684)
Taxes in respect of prior years	(2,800)	–	–
Other differences, net	(267)	(518)	354
Actual tax expenses	**$9,348**	**$11,003**	**$ 6,227**
Effective tax rate	**17.2%**	**21.2%**	**-**

Note 16 – CONTINGENT LIABILITIES AND COMMITMENTS

A. Royalty commitments

1. The Company and certain Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the Office of the Chief Scientist of Israel ("OCS") for the support of research and development activities conducted in Israel. At the time the participations were received, successful development of the related projects was not assured.

   In exchange for participation in the programs by the OCS, the Company and the subsidiaries agreed to pay 2% - 3.5% of total sales of products developed within the framework of these programs. The royalties will be paid up to maximum amount equaling 100% to 150% of the grants provided by the OCS, linked to the dollar and for grants received after January 1, 1999, also bearing annual interest at a rate based on LIBOR. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, payment of royalties is not required.

   In some cases, the Government of Israel participation (through the OCS) is subject to export sales or other conditions. The maximum amount of royalties is increased in the event of production outside of Israel.

   The Company and certain of its subsidiaries are also obligated to pay certain amounts to the Israeli Ministry of Defense and others on certain sales including sales resulting from the development of certain technology.

   Royalties expenses or accrued amounted to $6,661, $8,252 and $14,471 in 2000, 2001 and 2002, respectively.

2. In September 2001, the OCS issued "Regulations for the Encouragement of Research and Development in Industry" (rules for determining the level and payment of royalties) ("the regulations"). The regulations allow large R&D intensive companies to reach certain agreements with the OCS regarding determination of the amount and payment schedule of royalties, subject to certain conditions.

   If the Company elects to adopt the regulations, it will have to record a significant one-time expense resulting from accruing liability for an absolute amount of royalties.

   As of the date the financial statement was approved, the Company has not concluded discussions or finalized any agreements with the OCS with respect to the company.

   In May 2002 El-Op's Board of Directors approved an arrangement, proposed by the OCS, according to which El-Op will pay commencing in 2002 an agreed amount of $10,632 in exchange for a release from all obligations to pay royalties in the future. As a result El-Op recorded an expense for the agreed amount net of the accrual for royalties previously recorded by El-Op.

Note 16 – CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

B. Commitments in respect of long-term projects

In connection with long-term projects in certain countries, the Company and certain subsidiaries undertook to use its respective best efforts to make or facilitate purchases or investments in those countries at certain percentages of the amount of the projects. The companies' obligation to make or facilitate third parties making such investments and purchases is subject to commercial conditions in the local market, typically without a specific financial penalty. The maximum aggregate undertaking as of December 31, 2002 amounted to $715,000 to be performed over a period of up to 11 years, is typically tied to a percentage (up to 100%) of the amount of the specific contract.

In the opinion of management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one to one basis.

C. Legal claims

The Company and its subsidiaries are involved in legal claims arising in the ordinary course of business, including claims by employees, consultants and others. Company's management, based on the opinion of its legal counsel, believes the amount of such claims in excess of the accruals recorded in the financial statements will not have a material adverse effect on the financial position or results of operations of the Group.

D. Lease commitments

The future mininum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises, motor vehicles and office equipment are as of December 31, 2002:

2003	$8,197
2004	8,985
2005	4,834
2006	4,156
2007 and thereafter	3,877
	$ 30,049

Rent expenses for the years ended December 31, 2000, 2001 and 2002 amounted to $7,411, $7,978, and $9,215, respectively.

E. The Company has provided, on a proportional basis to its ownership interest, guarantees for two of its investees in respect of credit lines from banks amounting to $10,600 (2001- $10,700), of which $10,200 (2001 - $9,700) relates to a foreign investee owned 50% by El-Op. The guarantees will exist as long as the credit lines are in effect. The Company would be liable to perform under the guarantee for any debt the investee would be in default under the terms of the credit line.

Note 16 – CONTINGENT LIABILITIES AND COMMITMENTS (Cont.)

F. A lien on the Group's Approved Enterprises has been registered in favor of the State of Israel. Grants received in respect of projects which have not yet been approved amount to approximately $3,600.(see note 15 A (3) above).

G. Guarantees in the amount of approximately $374,000 were issued by banks securing certain advances from customers and performance bonds on behalf of Group companies.

H. Certain Group companies recorded fixed charges on most of their machinery and equipment, mortgages on most of their real estate and floating charges on most of their assets.

Note 17 – SHAREHOLDER'S EQUITY

A. SHARE CAPITAL

Ordinary shares confer upon their holders voting rights, the right to receive dividends and the right to share in excess assets upon liquiation of the Company.

B. 1996 EMPLOYEE STOCK OPTION PLAN

In 1996, the Company adopted an employee stock option plan pursuant to which options to buy 2,100,000 ordinary shares may be granted to employees. In April 1998, the Company amended the plan in order to be able to grant an additional 322,000 options. The exercise price approximates market price of the share at the grant date less 15%. The options vested over a period of two to four years from the date of grant and expire no later than six years from the date of grant. The plan is implemented in accordance with Section 102 of the Israeli Income Tax Ordinance.

C. 2000 EMPLOYEE STOCK OPTION PLAN

In 2000, the Company adopted another employee stock option plan for employees comprising options to purchase up to 2,500,000 ordinary shares. The exercise price approximates market price of the shares at the grant date. The plan includes an additional 2,500,000 options to be issued as "phantom" shares options that grant the option holders a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date, in consideration for their par value only. Options vest over a period of one to four years from the date of grant and expire no later than six years from the date of grant.

Any options, which are canceled or forfeited before expiration, become available for future grants. As of December 31, 2002, 466,042 options of the Company were still available for future grants.

D. "PHANTOM" SHARE OPTIONS

The phantom share options are considered as part of a variable plan as defined in APB 25, and accordingly the compensation cost of the options is measured by the difference between the market price of the Company's shares and the exercise price of the options at the end of every reporting period and amortized by the accelerated method over the remaining vesting period.

Note 17 – SHAREHOLDER'S EQUITY (Cont.)

E. A summary of the Company's share option activity under the plans is as follows:

	December 31,					
	2000		2001		2002	
	Number of options	Weighted average exercise prices	Number of options	Weighted average exercise prices	Number of options	Weighted average exercise prices
Outstanding-beginning of the year	1,471,830	$ 2.35	5,671,918	$ 11.26	5,107,634	$ 11.93
Granted	4,530,662	12.32	98,840	12.91	27,000	14.92
Exercised	(268,753)	7.64	(598,348)	11.93	(558,901)	9.45
Forfeited	(61,821)	7.13	(64,776)	12.50	(64,009)	11.33
Outstanding - end of the year	**5,671,918**	**$ 11.26**	**5,107,634**	**$ 11.93**	**4,511,724**	**$ 12.26**
Options exercisable at the end of the year	**748,760**	**$ 5.10**	**373,138**	**$ 7.56**	**2,287,790**	**$ 12.18**

The options outstanding as of December 31, 2002, have been separated into ranges of exercise price, as follows:

	Options outstanding			Options exercisable	
Exercise prices	Number outstanding as of December 31, 2002	Weighted average remaining contractual life (years)	Weighted average exercise prices per share	Number outstanding as of December 31, 2002	Weighted average exercise prices per share
$10.61-$12.16	252,853	1.45	$10.71	242,478	$10.67
$12.18-$15.07	2,135,897	3.92	12.35	1,024,368	12.39
$12.18-$15.07(*)	2,122,974	3.90	12.35	1,020,944	12.34
	4,511,724	**3.77**	**$12.26**	**2,287,790**	**$12.18**

(*) Phantom share options - see Note 20D.

Where the Company has recorded deferred stock compensation for options issued with an exercise price below the fair value of the ordinary shares, the deferred stock compensation is amortized and recorded as compensation expense ratably over the vesting period of the options. Compensation expense (income) of approximately $155, $8,512 and $(926) were recognized during the years ended December 31, 2000, 2001 and 2002, respectively.

Note 17 – SHAREHOLDER'S EQUITY (Cont.)

F. The weighted average exercise price of options granted during the years ended December 31, 2000, 2001 and 2002 were:

	Exceeds market price	Less than market price	
	Year ended December 31,		
	2000	2001	2002
Weighted-average exercise price	$ 12.32	$ 12.91	$ 14.92

G. COMPUTATION OF BASIC AND DILUTED NET EARNING (LOSS) PER SHARE

	Year ended December 31, 2002			Year ended December 31, 2001			Year ended December 31, 2000		
	Net income to shareholders of ordinary shares	Weighted averaged number of shares	Per share amount	Net income to shareholders of ordinary shares	Weighted averaged number of shares	Per share amount	Net loss to shareholders of ordinary shares	Weighted averaged number of share	Per share amount
Basic net earnings (losses)	$45,113	38,489	$1.17	$40,796	37,975	$1.07	$(20,531)	31,572	$(0.65)
Effect of dilutive securities: Emoloyee stock options	-	1,374		-	1,384		-	-	
Diluted net earnings (losses)	**$45,113**	**39,863**	**$1.13**	**$40,796**	**39,359**	**$1.04**	**$(20,531)**	**31,572**	**$(0.65)**

H. TREASURY SHARES

The Company's shares held by the Company are presented at cost and deducted from shareholders' equity.

I. DIVIDEND POLICY

In the event that cash dividends are declared by the Company, such dividends will be paid in NIS or in foreign currency subject to any statutory limitations. The Company has decided not to declare dividends out of tax exempt earnings.

Note 18 – MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

	Year ended December 31,		
	2002	**2001**	**2000**
A. REVENUES ARE ATTRIBUTED TO GEOGRAPHIC AREAS BASED ON LOCATION OF THE END CUSTOMERS AS FOLLOWS:			
Europe	$144,862	$179,560	$124,127
U.S.	267,686	206,627	189,147
Israel	225,674	226,650	159,593
Other	189,234	151,664	118,217
	$827,456	**$764,501**	**$591,084**
B. REVENUES ARE GENERATED BY THE FOLLOWING PRODUCTS:			
Airborne systems	$372,756	$334,201	$257,884
Armored vehicles systems	135,700	126,300	111,800
Command, control and communications systems	122,700	105,800	113,700
Electro-optical systems	148,200	162,700	91,100
Others	48,100	35,500	16,600
	$827,456	**$764,501**	**$591,084**
C. REVENUES FROM SINGLE CUSTOMERS, WHICH EXCEED 10% OF TOTAL REVENUES IN THE REPORTED YEARS:			
Customer A	18%	20%	26%

D. LONG-LIVED ASSETS BY GEOGRAPHIC AREAS:

	December 31,	
	2002	**2001**
U.S.	$83,814	$ 84,864
Israel	211,256	194,690
Other	13,660	10,451
	$308,730	**$290,005**

Note 19 – COST OF REVENUES

	Year ended December 31,		
	2002	**2001**	**2000**
Materials	$237,918	$182,936	$133,900
Labor	195,213	187,558	148,063
Subcontractors	126,579	129,057	78,983
Maintenance of buildings and services	30,643	28,824	15,374
Other manufacturing expenses	37,655	31,342	30,644
Depreciation	20,662	20,979	12,713
Royalties	14,471	8,252	6,661
	663,141	**588,948**	**426,338**
Amortization of intangibles assets	1,552	3,497	1,706
Increase (decrease) in provision for costs, warranties and expected losses	(4,257)	29	3,975
	660,436	**592,474**	**432,019**
Less:			
Cost of equipment produced for own use	5,517	4,913	6,651
Increase (decrease) in inventories of contracts in-progress	49,606	33,604	(7,418)
	55,123	**38,517**	**(767)**
	$605,313	**$553,957**	**$432,786**

Note 20 – RESEARCH AND DEVELOPMENT EXPENSES, NET

	Year ended December 31,		
	2002	**2001**	**200**
Total expenses	$62,560	$67,871	$53,251
Less – participations	5,550	9,112	8,977
	$57,010	**$58,759**	**$44,274**

Note 21– MARKETING AND SELLING EXPENSES

	Year ended December 31,		
	2002	**2001**	**2000**
Salaries and related expenses	$24,692	$23,379	$14,205
Constancy Fee's	24,782	20,648	11,546
Advertising and exhibitions	5,301	4,792	3,130
Depreciation	3,883	2,709	1,584
Other	7,033	3,348	7,984
	$65,691	**$54,876**	**$38,449**

Note 22 – GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31,		
	2002	**2001**	**2000**
Salaries and related expenses	$24,741	$27,113	$12,074
Office expenses	7,198	7,060	4,063
Depreciation and amortization	3,540	2,730	3,947
Other	6,172	6,313	6,167
	$41,651	**$43,216**	**$26,251**

Note 23 – FINANCING INCOME (EXPENSES), NET

	Year ended December 31,		
	2002	**2001**	**2000**
INCOME:			
Interest on cash equivalents and bank deposits	$1,547	$2,179	$2,574
Other	2,073	2,841	3,949
	3,620	**5,020**	**6,523**
EXPENSES:			
On long-term bank debt and debentures	2,026	3,033	1,442
On short-term bank credit and loans	3,415	3,806	3,626
Other	1,214	798	1,340
	6,655	**7,637**	**6,408**
	$(3,035)	**$(2,617)**	**$115**

Note 24 – OTHER INCOME (EXPENSES), NET

	Year ended December 31,		
	2002	**2001**	**2000**
Gain (loss) on disposal of property, plant and equipment	$(743)	$327	$597
Other, net	281	447	(594)
	$(462)	**$774**	**$3**

Note 25 – RELATED PARTIES TRANSACTIONS AND BALANCES

	Year ended December 31,		
	2002	2001	2000
INCOME			
Sales (*)	$37,924	$28,675	$11,168
Expenses charged	$902	$633	$626
COST AND EXPENSES			
Supplies and services	$10,457	$11,125	$7,392
Participation in expenses (*)	$1,498	$1,632	$1,464
Financial expenses	$110	$193	-

	December 31,	
	2002	2001
Trade receivables (*)	$9,647	$14,257
Trade payables	$4,006	$2,016

(*) The amounts relate mainly to transactions with VSI.

The Company's President and CEO is entitled for a three-year period, starting in July 2000, to an annual bonus of not less than 1% of the Company's net income after tax (excluding unusual expenses such as amortization of goodwill), and is also entitled to up to 10% of the number of options or shares issued by the Company to its employees and under the same terms (see Note 17). A former director of the Company received an annual bonus of 1% of the Company's net income after tax (excluding unusual expenses such as amortization of goodwill) from July 2000 to December 2001 and an additional bonus equal to the compensation derived from 400,000 options of the Company.

Note 26 – RECONCILIATION TO ISRAELI GAAP

As described in Note 1, the Company prepares its financial statements in accordance with U.S. GAAP. The effects of the differences between US GAAP and Israeli GAAP on the Company's financial statements are detailed below.

Differences between US GAAP and Israeli GAAP:

A building purchased from Elbit Ltd.

According to generally accepted accounting principles in Israel, the Company charged to capital reserves the excess of the amount paid over net book value of a building acquired from Elbit Ltd in 1999.

According to US GAAP, the entire amount paid is considered as the cost of the building acquired.

Proportional consolidation method

According to Israeli GAAP, a jointly controlled company should be included according to the proportional consolidation method. According to US GAAP, the investment in such a company is recorded according to the equity method.

Note 26 – RECONCILIATION TO ISRAELI GAAP (Cont.)

Tax benefit in respect of options exercised

According to Israeli GAAP, tax benefits from employee options exercised are recorded as a reduction of tax expense. According to US GAAP, the difference between the above mentioned tax benefits and the benefits recorded in respect of compensation expense in the financial statements is credited to capital reserves.

Goodwill

Effective January 1, 2002 the Company adopted SFAS 142, "Goodwill and Other Intangible Assets" according to which goodwill and intangible assets with indefinite lives are no longer amortized periodically but are reviewed annually for impairment (or more frequently if impairment indicators arise). According to Israeli GAAP, all intangibles, including goodwill should be amortized.

1. Effect on net income and earnings per share

	Year ended December 31,		
	2002	**2001**	**2000**
A. Net income (loss) as reported according to US GAAP	**45,113**	**40,796**	**(20,531)**
Adjustments to Israeli GAAP	(4,227)	1,767	1,822
Net earnings (loss) according to Israeli GAAP	**40,886**	**42,563**	**(18,709)**
B. Earnings per share			
Basic net income (loss) per share			
As reported according to US GAAP	1.17	1.07	(0.65)
As per Israeli GAAP	1.03	1.11	(0.59)
Diluted net income (loss) per share			
As reported according to US GAAP	1.13	1.04	(0.65)
As per Israeli GAAP	0.96	1.11	(0.59)

2. Effect on shareholders' equity

	As reported	Adjustments	As per Israeli GAAP
AS OF DECEMBER 31, 2002			
Shareholders' equity	411,361	(11,076)	400,285
AS OF DECEMBER 31, 2001			
Shareholders' equity	377,985	(12,149)	365,836